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SUBJECT: UZBEKISTAN 2009 INCSR REPORT - PART II: FINANCIAL CRIMES AND MONEY LAUNDERING

OVERVIEW

¶1. Uzbekistan is not an important regional financial center and does not have a well-developed financial system. Corruption, narcotics trafficking and smuggling generate the majority of illicit proceeds. Local and regional drug-trafficking and other organized crime organizations control narcotics proceeds and proceeds from other criminal activities, such as smuggling of cash, high-value transferable assets (e.g., gold), property, or automobiles. Uzbekistan is home to a significant black market for smuggled goods. Since the Government of Uzbekistan (GOU) imposed a very restrictive trade and import regime in the summer of 2002, smuggling of consumer goods, already a considerable problem, increased dramatically. In April 2009, the GOU passed legislation to reestablish an anti-money laundering regime that had been suspended by Presidential decree until 2013, for which Uzbekistan drew heavy criticism from the Financial Action Task Force (FATF) and international community. The new legislation represents a step forward in Uzbekistan's commitment to combat financial crimes but it is too early to assess implementation or impact.

¶2. Many Uzbek citizens continue to make a living by illegally shuttle-trading goods from neighboring countries and regions, including China, Turkey, Iran, India, Korea, the Middle East, Europe, and the U.S. The black market for smuggled goods does not appear to be significantly funded by narcotics proceeds, but, as noted above, drug dealers use the robust black market to launder drug-related money.

¶3. Legitimate business owners, ordinary citizens, and foreign residents generally attempt to avoid using the Uzbek banking system for transactions because of the onerous nature of the GOU's financial control system, fear of GOU seizure of assets, and lack of trust in the banking system as a whole. The Central Bank of Uzbekistan (CBU) states that deposits from individuals have been increasing in recent years, but it is still seeking to increase consumer confidence in banks.

¶4. The CBU, General Prosecutor's Office (GPO), and the National Security Service (NSS) closely monitor all domestic banking transactions for tax and currency control purposes. In particular, banks are required to know, record, and report the identity of customers engaging in significant transactions, including the recording of large currency transactions based on a multiple of the minimum wage. The CBU unofficially requires commercial banks to report on private transfers to foreign banks exceeding U.S.

\$10,000.

¶ 15. The unofficial, unmonitored cash-based market creates an opportunity for small-scale terrorist or drug-related laundering activity destined for internal operations. For the most part, the funds generated by smuggling and corruption are not directly laundered through the banking system, but through seemingly legitimate businesses, such as restaurants and high-end retail stores. Although Uzbek financial institutions are not known to engage in illegal transactions in U.S. currency, illegal unofficial exchange houses, where the majority of cash-only money laundering takes place, deal in Uzbek soum and U.S. dollars. Moreover, drug dealers and others can transport their criminal proceeds in cash across Uzbekistan's porous borders for deposit in the banking systems of other countries, such as Kazakhstan, Russia or the United Arab Emirates.

LEGAL FRAMEWORK

¶ 16. Money laundering from the proceeds of drug-trafficking and other criminal activities is a criminal offense. Article 41 of the Law on Narcotic Drugs and Psychotropic Substances (1999) stipulates that any institution may be closed for performing a financial transaction for the purpose of legalizing (laundering) proceeds

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derived from illicit narcotics trafficking. The law protects reporting individuals with respect to their cooperation with law enforcement entities. The GOU has not adopted "banker negligence" laws holding individual bankers responsible if their institutions launder money.

¶ 17. The Law on Banks and Bank Activity (1996), article 38, stipulates conditions under which banking information can be released to law enforcement, investigative and tax authorities, prosecutor's office and courts. Different conditions for disclosure apply to different types of clients-individuals and institutions. In September 2003, Uzbekistan enacted a bank secrecy law that prevents the disclosure of client and ownership information for domestic and offshore financial services companies to bank supervisors and law enforcement authorities. In all cases, banks can disclose private information to prosecution and investigation authorities if a criminal investigation is underway. They can provide information to the courts on the basis of a written request in relation to cases currently under consideration. Tax authorities can also obtain protected banking information in cases involving the taxation of a bank's client. GOU officials note that the secrecy law does not apply if a group is on a list of designated terrorist organizations.

¶ 18. Penalties for money laundering are from ten to fifteen years imprisonment, under Article 243 of the Criminal Code. This article defines the act of money laundering to include as punishable acts the transfer; conversion; exchange; or concealment of origin, true nature, source, location, disposition, movement and rights with respect to the assets derived from criminal activity.

¶ 19. The Department of Investigation of Economic Crimes within the Ministry of Internal Affairs (MVD) conducts investigations of all types of economic offenses. A specialized structure within the NSS and the Department on Tax, Currency Crimes and Legalization of Criminal Proceeds under the GPO are also authorized to conduct investigations of money laundering offenses. The Department of Tax, Currency Crimes and Legalization of Criminal Proceeds is the

functional equivalent of a Financial Intelligence Unit (FIU). Officials from the GPO reported that there were 103 money laundering-related cases from January 2006 through November 2009, which resulted in 38 convictions.

¶10. In 2004, Uzbekistan enacted a basic AML/CFT regime that contained a range of AML/CFT provisions, including customer due diligence (CDD), record keeping, and reporting. While the AML/CFT law went into effect on 1 January 2006, important parts of the law were suspended until 1 January 2013 pursuant to several presidential decrees and an additional law in 2007. These actions drew heavy criticism from the international community and led the FATF ICRG to review the AML/CFT situation in Uzbekistan.

¶11. In April 2009, the GOU responded to international concerns by re-enacting many of the 2004 AML/CFT provisions. The new legislation falls short of international standards in some areas but does represent a step forward from the ill-fated earlier law. In particular, provisions on CDD are improved, and the law extends the list of entities explicitly subject to anti-money laundering to include non-banking institutions, such as jewelers and real estate brokers. These April changes have had a cascading effect, as portions of sixteen other laws had to be amended to bring them into compliance with the new legislation. Parliament adopted the first of several follow-on amendments to the AML law in September 2009, which took effect in November 2009. These regulations include the elimination of bearer bonds and bearer deposit savings books. Representatives from the GPO state that they expect to submit additional recommendations to Parliament in the first quarter of 2010 to further refine the AML rules and eliminate legislative contradictions.

¶12. The new AML regulations reportedly have had a significant impact on suspicious transaction reporting. Previously, Uzbek bank

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generally reported all transactions exceeding the minimum "alert" threshold. According to the GPO, this led to over-reporting and stretched resources too thin. The new regulations provide banks with more concrete guidelines for assessing suspicious activity, theoretically leading to greater efficiency in the investigation of potential money laundering. The GPO notes that previously, the FIU received, on average, 1,500 suspicious activity reports per month. Since the new legislation went into effect in November 2009, this number is only 187. One of these transactions has led to criminal charges.

¶13. In its October 2009 statement, the Financial Action Task Force (FATF), an international inter-governmental body that promotes policies to combat money laundering and terrorist financing, welcomed the recent steps that Uzbekistan has taken to establish the new AML/CFT framework and urged Uzbekistan to continue its progress towards implementing effective AML/CFT measures. The FATF noted that it will continue to monitor the progress being made in Uzbekistan and will reconsider in February 2010 the measures that are currently in place to protect jurisdictions' financial sectors from AML/CFT risks emanating from Uzbekistan.

¶14. Existing controls on transportation of currency across borders would, in theory, facilitate detection of the international transportation of illegal source currency. When entering or exiting the country, foreigners and Uzbek citizens are required to report all currency they are carrying. Residents and nonresidents may bring the equivalent of U.S. \$10,000 into the country tax-free, and authorities assess a one-percent duty on amounts in excess of this limit. Customs officers at Tashkent Airport vigorously enforce this

limit and target foreign nationals for careful searches as they depart the country. Those caught in possession of more currency than they declared upon entering Uzbekistan are assessed severe fines and may face criminal charges. Residents may export up to the equivalent of U.S. \$2,000. Residents wishing to take out higher amounts must obtain authorization to do so; amounts over U.S. \$2,000 must be approved by an authorized commercial bank, and amounts over U.S. \$5,000 must be approved by the CBU. International cash transfers to or from an individual person are limited to U.S. \$5,000 per transaction; there is no monetary limit on international cash transfers made by legal entities, such as a corporation. However, Uzbekistan does not permit direct wire transfers to or from other Central Asian countries; a third country must be used.

OFFSHORE FINANCIAL TRANSACTIONS

¶15. Uzbekistan is not an offshore financial center. Uzbekistan permits offices of international business companies, which are subject to the same regulations as domestic businesses, but prohibits offshore banks. Other forms of exempt or shell companies are not officially present. Casinos are illegal in Uzbekistan.

FREE TRADE ZONES

¶16. Uzbekistan has established the Free Industrial Economic Zone (FIEZ) in Navoi, a province located in the central part of Uzbekistan. Development of the zone is still in its early stages. There is no indication that the Navoi free trade zone is used in trade-based money laundering schemes or by financiers of terrorism.

TERRORIST FINANCING

¶17. Article 155 of Uzbekistan's Criminal Code and the law "On Fighting Terrorism" criminalize terrorist financing. The latter law names the NSS, the MVD, the Committee on the Protection of State Borders, the State Customs Committee, the Ministry of Defense, and the Ministry for Emergency Situations as responsible for

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implementing the counterterrorist legislation, and designates the NSS as the coordinator for government agencies fighting terrorism. The GOU has the authority to identify, freeze, and seize terrorist assets. Uzbekistan has circulated to its financial institutions the names of suspected terrorists and terrorist organizations listed on the UN 1267 Sanctions Committee's consolidated list. In addition, the GOU has circulated the list of Specially Designated Global Terrorists designated by the United States pursuant to E.O. 13224 to the CBU, which has, in turn, forwarded these lists to banks operating in Uzbekistan. According to the CBU and the Office of the State Prosecutor, no assets have been frozen.

¶18. Other than a plan to step up enforcement of currency regulations, the GOU has taken no steps to regulate alternative remittance systems such as hawala, or deter black market exchanges, trade-based money laundering, or the misuse of gold, precious metals and gems. GOU officials noted that most overseas migrants work in more advanced countries, such as Russia or Korea, where financial institutions track remittances. Although officially there is complete currency convertibility, in reality, authorities can significantly delay or outright refuse the conversion, and do so during such times as the annual autumn cotton harvest, when cash

supplies are needed internally to support the extensive mobilization of people and machinery to collect the crop. Foreign companies complain that they must wait over six months to convert the profits from local sales into foreign currencies in order to transfer the money out of Uzbekistan.

¶19. The GOU closely monitors the activities of charitable and nonprofit entities, such as NGOs, that terrorism financiers could exploit. In February 2004, the Cabinet of Ministers issued Decree 56 to allow the government to vet grants to local NGOs from foreign sources, ostensibly to fight money laundering and terrorist financing. Given the high level of supervision of charities and other nonprofits, and the perceived threat from the Islamic Movement of Uzbekistan (IMU) and other extremist organizations, it is unlikely that the NSS would knowingly allow any funds to be funneled to terrorists through Uzbekistan-based charitable organizations or NGOs.

¶20. Uzbekistan has established systems for identifying, tracing, freezing, seizing, and forfeiting proceeds of both narcotics-related and money laundering-related crimes. Current laws include the ability to seize items used in the commission of crimes, such as conveyances used to transport narcotics, farm facilities (except land) where illicit crops are grown or which are used to support terrorist activity, legitimate businesses if related to criminal proceeds and bank accounts. The banking community, which is entirely state-controlled and with few exceptions, state-owned, cooperates with efforts to trace funds and seize bank accounts. Uzbek law does not allow for civil asset forfeiture, but the Criminal Procedure Code provides for "civil" proceedings within a criminal case to decide forfeiture issues. As a practical matter, authorities conduct these proceedings as part of the criminal case. The obstacles to enacting such laws are largely rooted in the widespread corruption that exists within the country.

¶21. In 2000, Uzbekistan established a special fund to direct confiscated assets to law enforcement activities. In 2004, the Cabinet of Ministers closed the Special Fund. Under the new procedure, each agency manages the assets it seizes. There is also a specialized fund within the MVD to reward those officers who directly participate in or contribute to law enforcement efforts leading to the confiscation of property. This fund has generated 20 percent of its assets from the sale of property confiscated from persons who have committed offenses, such as the organization of criminal associations, bribery and racketeering. The GOU is believed to enforce existing drug-related asset seizure and forfeiture laws enthusiastically, although there is no information regarding the total dollar value of crime related assets. Reportedly, existing legislation does not permit sharing of seized narcotics assets with other governments.

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INTERNATIONAL COOPERATION

¶22. The GOU realizes the importance of international cooperation in the fight against drugs and transnational organized crime and has made some efforts to integrate the country into the system of international cooperation. Uzbekistan has entered into bilateral agreements for cooperation or exchange of information on drug related issues with the United States, Germany, Italy, Latvia, Bulgaria, Poland, China, Iran, Pakistan, the Commonwealth of Independent States (CIS), and all the countries in Central Asia. It has multilateral agreements under the framework of the CIS and the Shanghai Cooperation Organization, and under memoranda of understanding.

¶23. Uzbekistan signed an "Agreement on Narcotics Control and Law Enforcement Assistance" with the United States on August 14, 2001, with two supplemental agreements that came into force in 2004. Uzbekistan does not have a Mutual Legal Assistance Treaty with the United States. However, Uzbekistan and the United States have reached informal agreement on mechanisms for exchanging adequate records in connection with investigations and proceedings relating to narcotics, terrorism, terrorist financing and other serious crimes. In the past, Uzbekistan has cooperated with appropriate law enforcement agencies of the USG and other governments investigating financial crimes and several important terrorist-related cases. Cooperation in these areas became increasingly problematic in an atmosphere of strained U.S.-Uzbekistan bilateral relations, but there was significant improvement in 2009. In a major step towards more effective bilateral cooperation, the GOU accredited a "Counternarcotics Affairs Office" (CAO) staffed by the U.S. Drug Enforcement Administration (DEA). The CAO will focus its efforts on strengthening Uzbek institutions and building the operational and investigative capacity of Uzbek law enforcement agencies.

¶24. Uzbekistan has been a member of the Eurasian Group on Combating Money Laundering and the Financing of Terrorism (EAG), a FATF-style regional body, since 2005. In November 2009, EAG experts conducted an in-country evaluation in Uzbekistan. The evaluation report will be discussed at the 12th EAG Plenary in June 2010, and EAG will submit its finding to the FAFT at its February 2010 meeting. Representatives from the GPO state that the EAG's findings were generally positive.

¶25. The GOU is an active party to the relevant agreements concluded under the CIS, the Central Asian Economic Community (CAEC), the Economic Cooperation Organization (ECO), and the Shanghai Cooperation Organization. Uzbekistan is a party to the 1988 UN Drug Convention, the UN Convention for the Suppression of the Financing of Terrorism, the UN Convention against Transnational Organized Crime, and the UN Convention against Corruption.

¶26. The GOU has accepted international technical assistance for drafting bylaws as well as general implementation guidance to restore its AML regime and bring it into further into compliance with FAFT recommendations. A joint World Bank/UNODC/IMF Workshop on an effective AML/CFT framework and mutual evaluation was organized from 27 to 28 October 2009 in Tashkent. The IMF also organized a second one-day workshop on October 29 in Tashkent specifically for Uzbek banks. On 5 October 2009, the Russian Federation and Uzbekistan signed an agreement on technical assistance cooperation for AML/CFT in Moscow. Under the agreement, Russia will provide the Uzbek FIU with technical and advisory assistance for harmonizing the new, national AML/CFT with existing law, enhancing the effectiveness of the FIU activities and creating an IT-system for collecting, storing, and processing data.

¶27. A lack of trained personnel, resources, and modern equipment continues to hinder Uzbekistan's efforts to fight money laundering and terrorist financing. The GOU has made progress by re-enacting AML/CFT legislation that provides a framework for the Uzbek FIU to function effectively and is generally compliant with FAFT recommendations. Assuming additional restoration of Uzbekistan's

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AML/CFT regime through further bylaws, much will depend on the FIU's ability to become fully operational and to cooperate effectively with other GOU law enforcement and regulatory agencies in receiving and disseminating information on suspicious transactions.

BUTCHER